

# 2016 Tax Preference Performance Reviews

## JLARC Staff Presentation to the Joint Legislative Audit and Review Committee

### JLARC Staff

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Joint Legislative Audit & Review Committee

July 2016



# 2006 legislative mandate: conduct performance audits of tax preferences

## Legislature (Chapter 43.136 RCW):

- **Created** the Citizen Commission for Performance Measurement of Tax Preferences
- **Specified** JLARC to review preferences over 10-year cycle
- **Outlined** specific questions for JLARC staff to answer
- **Required** audit recommendation
- Key questions: public policy objective stated?  
Achieved?

# Steps in process repeated each year

In 2015, Commission determined 10-year review schedule and preferences for JLARC staff review

**July 2016:** Staff present to JLARC Committee

**Aug:** Staff will present to Citizen Commission

**Sept:** Commission will take public testimony

**Oct:** Commission will adopt comments

**Dec:** JLARC will hear final report

**Jan 2017:** Joint fiscal committee hearing

# Today's focus is 5 of the 22 reports

**Syrup Tax Paid (B&O Tax)**

**Customer-Generated Power (Public Utility Tax)**

**Timber and Wood Products (B&O Tax)**

**Data Center Equipment (Sales and Use Tax)**

**Trade-Ins (Sales and Use Tax)**

# Syrup Tax Paid

B&O Tax



# Syrup tax paid (B&O tax)

**B&O tax credit** for \$1/gallon syrup tax paid by businesses that **buy carbonated drink** syrup and **use to make drinks** they **sell** to customers (e.g., restaurants, convenience stores)



2017-19  
Estimated Beneficiary  
Savings

**\$10<sub>M</sub>**

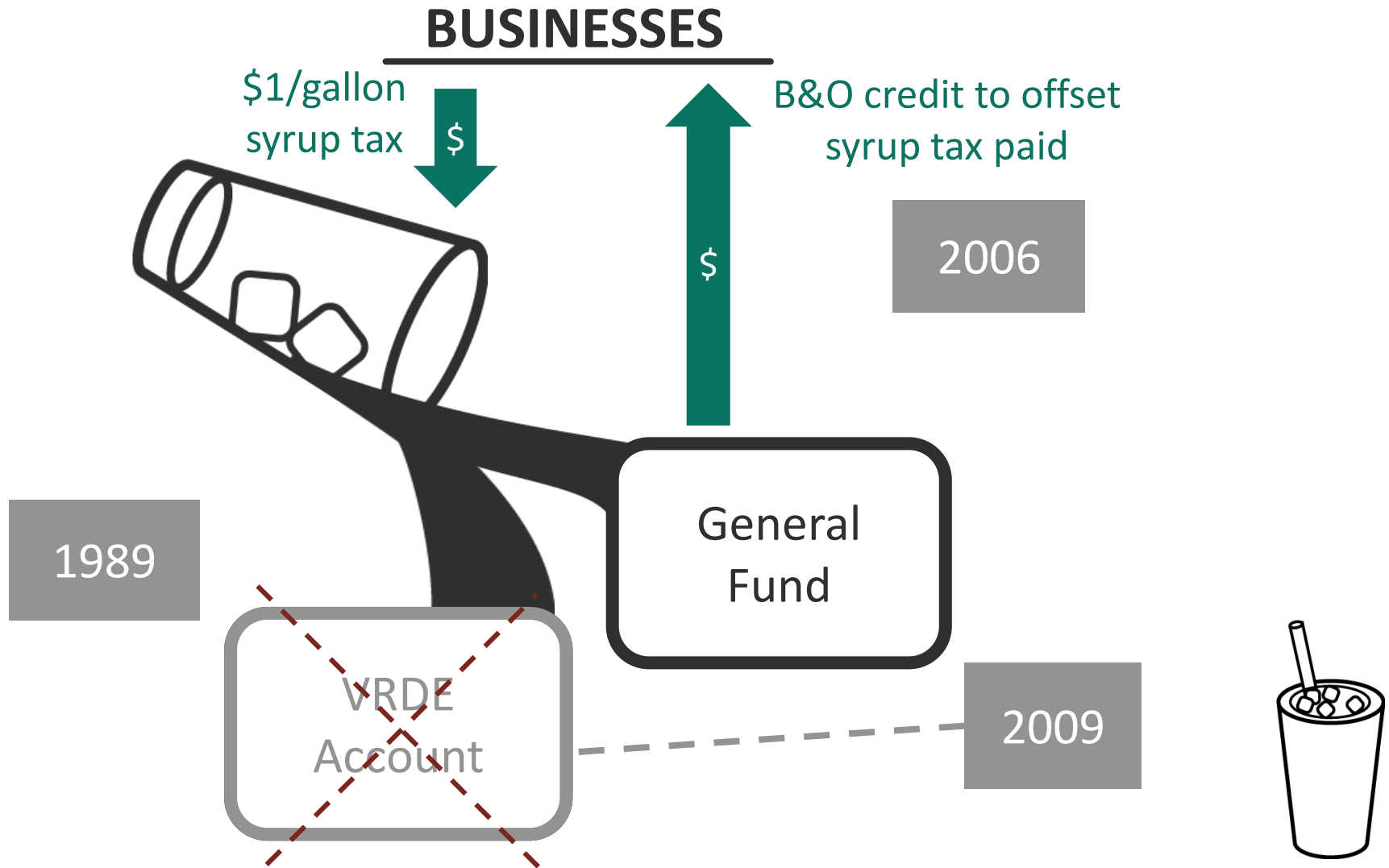
Beneficiaries

2,326 in FY 2015

**Legislative Auditor recommends:**

**Repeal the syrup tax**  
**Terminate this tax preference**

# Syrup tax created in 1989 to fund drug and alcohol abuse programs (VRDE account)



# Public policy objective not stated

Inferred Objective	Objective Met?
<b>Provide tax relief</b> to the restaurant industry <b>while maintaining funding</b> for the Violence Reduction and Drug Enforcement (VRDE) account	<div><div>—</div><div>No<ul style="list-style-type: none"><li>• Preference <b>not providing tax relief to all eligible businesses</b> that pay syrup tax<ul style="list-style-type: none"><li>○ 40% of B&amp;O credit available not claimed each year</li></ul></li><li>• Objective to maintain VRDE funding <b>no longer relevant</b><ul style="list-style-type: none"><li>○ VRDE account eliminated in 2009</li></ul></li></ul></div></div>





# Recommendation: Repeal syrup tax and associated B&O tax credit

## Eliminate syrup tax

Would achieve objective of **providing tax relief**

Since 2009, syrup tax revenues **no longer fund violence & drug enforcement account**

## Repeal preference

B&O preference unnecessary if syrup tax repealed. Preference **not providing all the intended tax relief** to businesses paying syrup tax



# Customer-Generated Power

## Public Utility Tax



# Customer-generated power (public utility tax)



Customer  
**generates**  
**power**



Utility **pays**  
**customer** based  
on the power  
generated



State gives  
utility a **tax**  
**credit**

**Current**  
**Expiration**  
**Date: 2021**

**\$55M**

2017-19  
Estimated  
Beneficiary  
Savings

39 utilities claimed  
**Beneficiaries**

**Public utility tax**  
**credit** for payments  
utilities make to their  
customers who  
generate own  
renewable energy

**Legislative Auditor Recommends:**  
**Review and Clarify** this tax  
preference



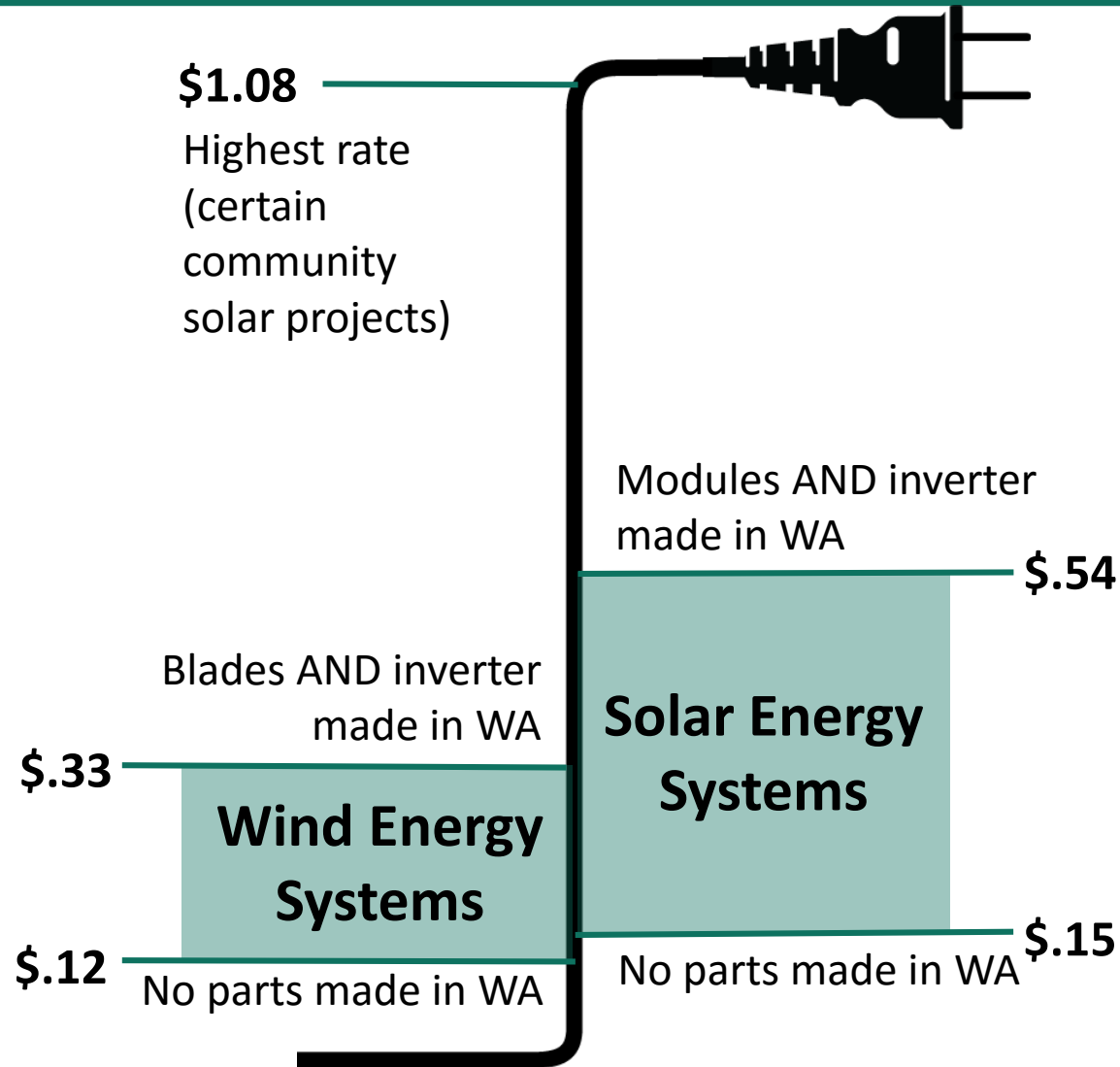
# Incentive amounts depend on type of system and where it was made

Three types of systems qualify:


- Solar
- Wind
- Anaerobic digester

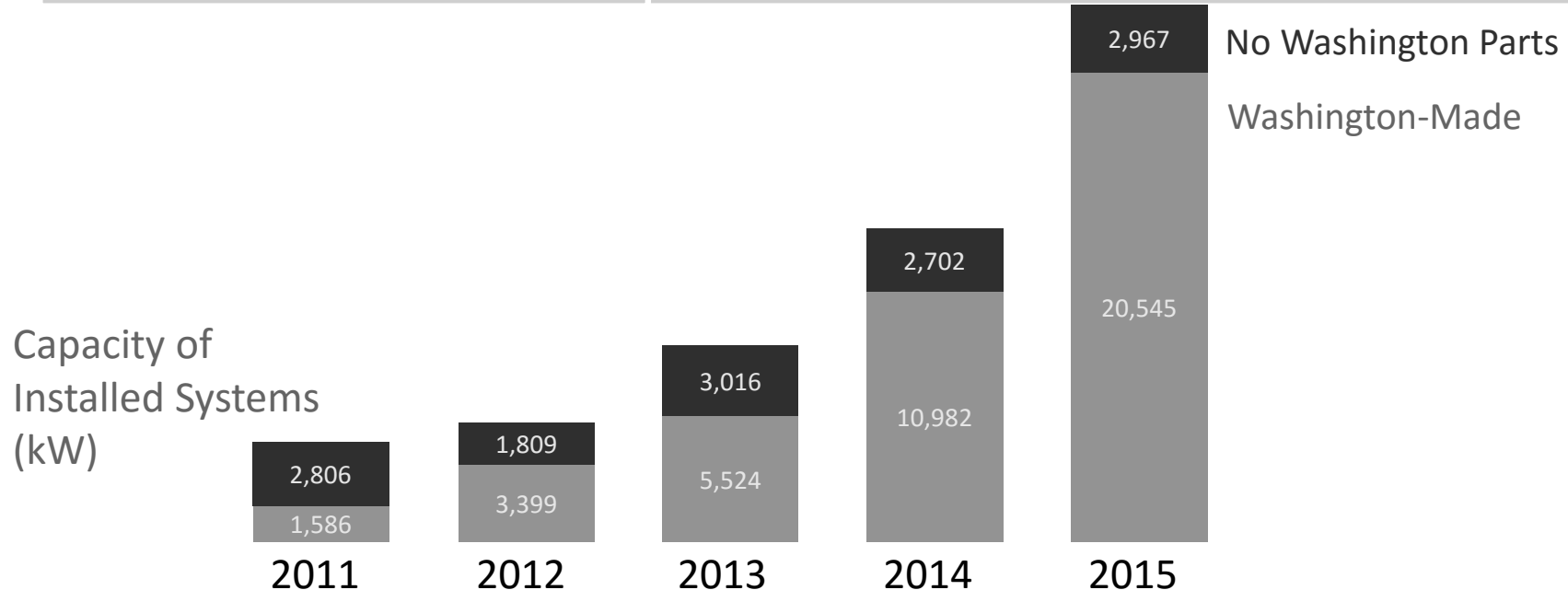
Higher incentive rates for some Washington-made components

Higher incentive rates for community solar



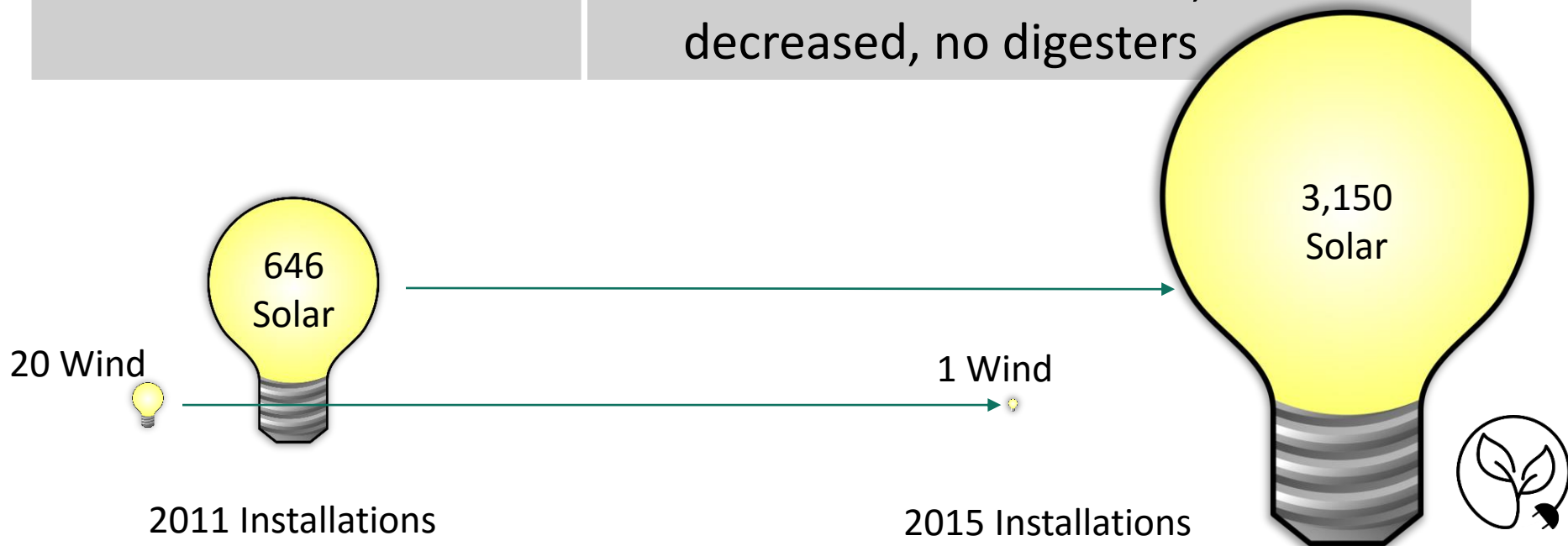
# Two public policy objectives

Stated objective	Objective met?
Greater use of locally created renewable energy technologies	 <b>Yes</b> <ul style="list-style-type: none"> <li>More systems installed, more of those systems made in Washington</li> </ul>





# Two public policy objectives

Stated objective	Objective met?
Greater use of locally created renewable energy technologies	<div>✓ <b>Yes</b></div> <ul style="list-style-type: none"><li>• More systems installed, more of those systems made in Washington</li><li>• Growth is all from solar; wind has decreased, no digesters</li></ul>



# Two public policy objectives

Stated objective	Objective met?
Greater use of locally created renewable energy technologies	 <b>Yes</b> <ul style="list-style-type: none"><li>• More systems installed, more of those systems made in Washington</li><li>• Growth is all from solar, wind has decreased</li></ul>
Support and retain existing local industries, create new opportunities for industries	 <b>Unclear</b> <ul style="list-style-type: none"><li>• Installation of Washington-made systems has increased</li><li>• Growth concentrated in solar, three companies</li></ul>



# Sixteen utilities reaching their caps in 2016

Each utility **capped** at \$100,000 or 0.5% of taxable power sales

- Some **cutting off programs** to new customers, others **reducing rate** for all
- Serve **71%** of WA customers





# Recommendation: Review and Clarify the Preference

## Clarify

Use of locally made systems has grown

**Growth is concentrated** in solar, small number of manufacturers

## Inform

**Include targets** for number of systems, how much power generating capacity, specify which local industries



# Timber and Wood Products

## B&O Tax



# Timber and wood products (B&O tax)

**Current  
Expiration  
Date: 2024**

**Reduced B&O Tax  
rate (0.3424%)** for  
extracting, timber  
and wood product  
manufacturing and  
wholesaling, and  
standing timber  
sales



2017-19  
Estimated Beneficiary  
Savings



**\$30.6M**

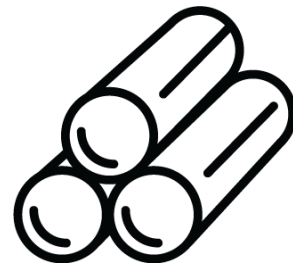
Beneficiaries

1,129 timber  
industry  
businesses (FY15)

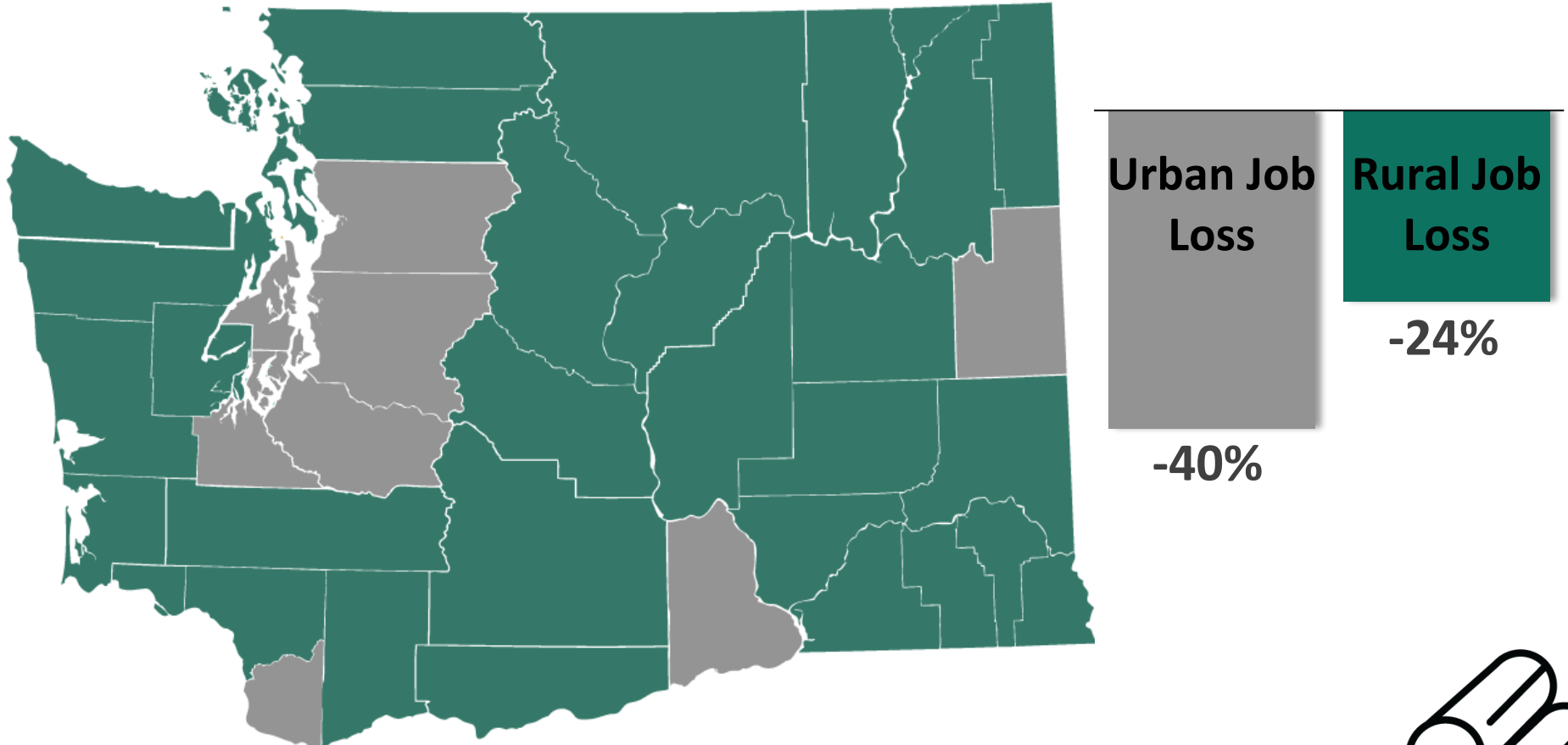
**Legislative Auditor recommends:  
Review and Clarify**

# Public policy objectives not stated

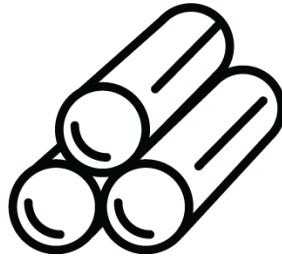
Inferred Objective	Objective Met?
<b>Reduce cost of doing business</b> for the timber industry	 <b>Yes</b> <ul style="list-style-type: none"><li>• 0.3424% applicable rate vs. 0.484% general rate</li></ul>
<b>Help retain good paying jobs in rural areas</b> (especially manufacturing jobs)	 <b>Unclear</b> <ul style="list-style-type: none"><li>• 31% overall drop in WA timber industry jobs 2006 to 2014</li><li>• Rural counties had less job loss than non-rural counties</li></ul>



# Since 2006, timber industry jobs decreased less in rural counties



Source: ESD data, 2006-14



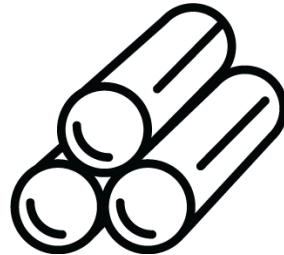
# In rural counties, average timber industry wage are higher than average job wage

**\$58K**  
Timber Job



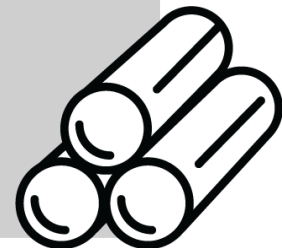
**\$37K**  
Average Job

Source: ESD data, 2014



# Public policy objectives not stated

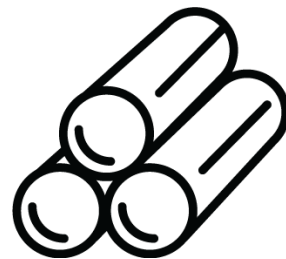
Inferred Objective	Objective Met?
Reduce cost of doing business for the timber industry	✓ Yes 0.3424% applicable rate vs. 0.484% general rate
Help retain good paying jobs in rural areas (especially manufacturing jobs)	? Unclear <ul style="list-style-type: none"><li>• 31% overall drop in WA timber industry jobs 2006 to 2014</li><li>• Rural counties had less job loss than non-rural counties</li></ul>
Help timber industry <b>compete</b> nationally and internationally	? Unclear Evidence is mixed



# Since 2006, WA's national ranking for share of timber industry jobs has declined

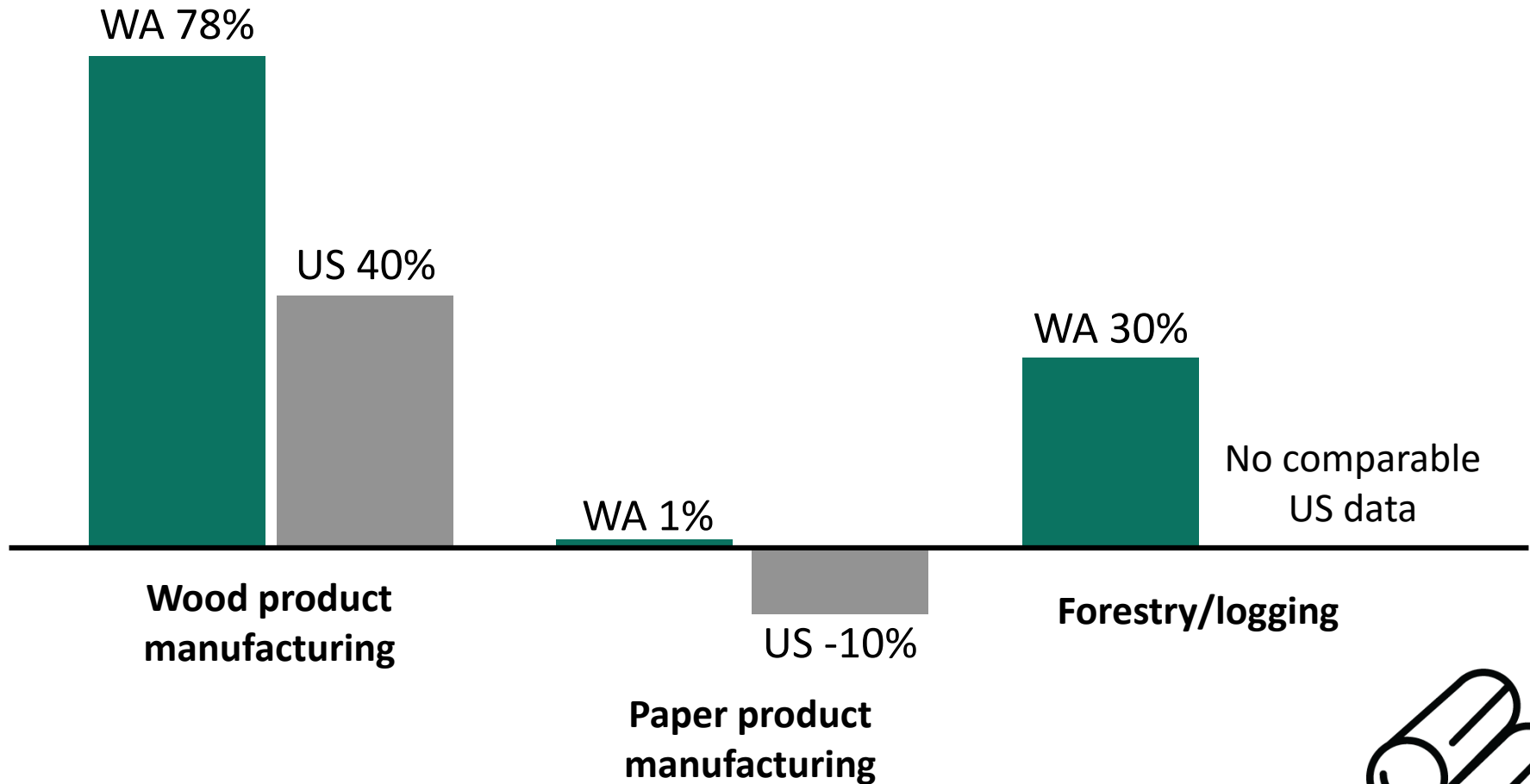
Industry	State Rank	
	2006	2015
Wood product manufacturing	13 <sup>th</sup>	16 <sup>th</sup>
Paper product manufacturing	17 <sup>th</sup>	21 <sup>st</sup>
Forestry/logging	8 <sup>th</sup>	9 <sup>th</sup>

Source: U.S. BLS data, 2006-15

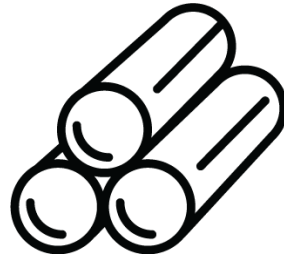




# Productivity per job has increased in WA, 2006-2013



Source: ESD data and BLS data, DNR harvest data, 2006-2013



# Recommendation: Review and Clarify

## Review

While it is **reducing the cost of business**, it is **unclear** how the preference is **impacting employment and competitiveness**



## Clarify

Legislature should provide a **performance statement identifying the public policy objectives** and **providing targets and metrics** to measure if objectives achieved

# Data Center Equipment

## Sales & Use Tax



# Data center equipment (sales & use tax)

**Sales & use tax exemption** for purchases of eligible server equipment and power infrastructure



2017-19  
Estimated Beneficiary  
Savings

**\$111.6M**

Beneficiaries

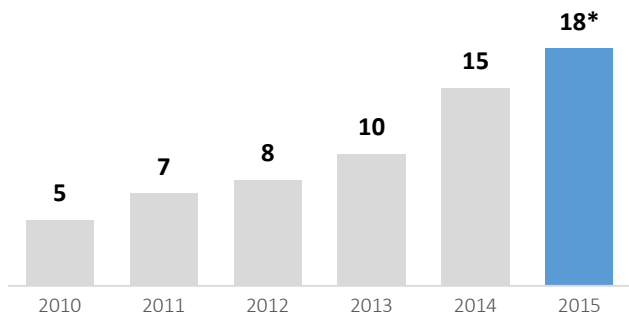
15 in 2014

**Legislative Auditor recommends:**

**Continue**

# Public policy objectives stated

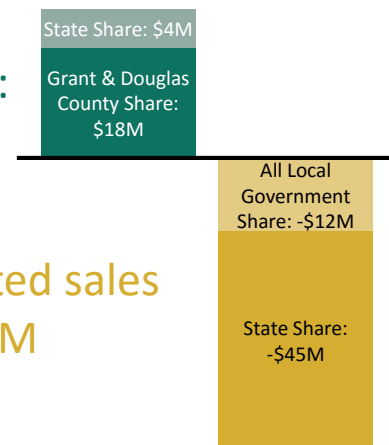
Stated Objective	Objective Met?
Improve industry competitiveness through increased investment in data centers	<div>✓ Yes</div> <ul style="list-style-type: none"> <li>• More businesses invest in data centers &amp; claim exemption</li> <li>• Beneficiaries: assessed values grew \$1.2 billion, property taxes paid grew \$13 million during 2011-2015</li> </ul>





\* Potential, estimated by JLARC staff based on exemption certificates issued.

FY 16 estimated property tax gain: \$22M

FY 16 estimated sales tax loss: -\$57M



# Public policy objectives stated

Stated Objective	Objective Met?
Improve industry competitiveness through increased investment in data centers	 <b>Yes</b> <ul style="list-style-type: none"> <li>• More businesses invest in data centers &amp; claim exemption</li> <li>• Beneficiaries: assessed values grew \$1.2 billion, property taxes paid grew \$13 million during 2011-2015</li> </ul>
Create family-wage jobs <ul style="list-style-type: none"> <li>• Permanent/full-time</li> <li>• At the data center</li> <li>• 150% of county per-capita income</li> </ul>	 <b>Too early to tell</b> <ul style="list-style-type: none"> <li>• Beneficiaries have 6 years to meet job creation requirements</li> <li>• Only one beneficiary has reached the deadline by May 2016</li> </ul>



# Tax savings are contingent on job creation

- Preference includes a **claw-back provision** requiring tax savings be **repaid** if beneficiaries **do not meet** job targets
- Department of Revenue verifies job creation



# Recommendation: Continue

## Continue

Tax preference performance statement:

“[T]he Legislature **intends to extend** the expiration date of the tax preference if a review finds that the rural county tax base is increased as a result of the construction of data centers eligible for the tax preference.”

The review finds that **the rural county tax base has increased**





# Trade-Ins

## Sales and Use Tax



# Trade-ins (sales and use tax)

People with **like-kind trade-ins** pay **less sales or use tax** because the trade-in value **reduces the sale price used to calculate** sales or use tax

2017-19  
Estimated Beneficiary  
Savings

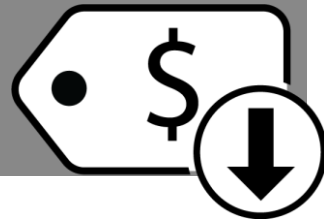
**\$591.4M**

Beneficiaries

Unknown; 82% of  
FY15 value from  
vehicle trade-ins

Legislative Auditor recommends:

**Review and Clarify**



# Trade-in preference reduces the sale price used to calculate the sales/use tax on purchases

## Without Preference



New Car

\$30K



Trade In

(Sales price not subtracted)

\$30K

x 9.3%

*Sales Tax Due*

\$2,790 tax

## With Preference



New Car

\$30K



— Trade In

(10K)

\$20K

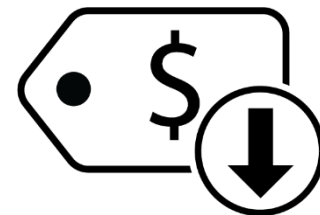
x 9.3%

*Sales Tax Due*




\$1,860 tax

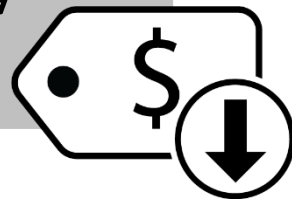
*Tax Savings*

\$930



# Preference is mixed in achieving stated and inferred objectives

Stated Objective	Objective Met?
Reduce amount on which sales tax paid by excluding trade-in value	 Yes
Inferred Objectives	Objectives Met?
Make WA consistent with other states	 Yes 30 states have broad exemptions, 11 limit trade-ins in some way
Stimulate sales to offset loss of revenue due to the preference	 No Additional sales generated by preference do not offset loss



# Taxes collected on additional **vehicle sales** not large enough to offset preference

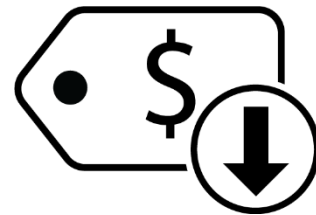
JLARC staff estimated **range** of how much vehicle sales and related economic activity would increase due to preference

**\$31M**

With most optimistic estimate of vehicle sales, increase in tax revenue not enough to offset losses

**-\$182M**

Preference causes overall decrease in sales tax revenue from vehicles

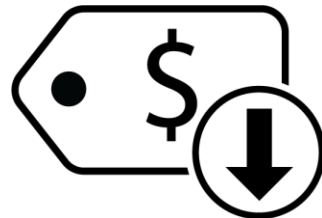


Source: JLARC staff estimate of FY16 DOR vehicle sales using historic data

# Recommendation: Review and Clarify

## Clarify

While the preference is reducing consumers' taxes and making Washington's tax treatment consistent with other states, it is **not achieving** the inferred objective of **stimulating enough additional sales to replace lost revenue**



# 2016 reviews summary: Legislative Auditor recommends continue 4, modify 1 preference

## Continue

**Custom Software (Sales and Use Tax)**

**Data Center Equipment (Sales and Use Tax)**

**Self-Service Laundries (Sales and Use Tax)**

**Standing Timber Sales (Real Estate Excise Tax)**

## Modify

**Rural Electric Cooperative Finance Orgs (B&O Tax)**

# 2016 reviews summary: Legislative Auditor recommends review and clarify 8 preferences

## Review and Clarify

**Clay Targets (Sales and Use Tax)**

**Customer-Generated Power (Public Utility Tax)**

**Flavor-Imparting Items (Sales and Use Tax)**

**Semiconductor Materials Manufacturing Preferential  
Rate (B&O Tax)**

**Semiconductor Materials Manufacturing Gases and  
Chemicals (Sales and Use Tax)**

**Solar Energy and Silicon Product Manufacturers (B&O  
Tax)**

**Timber and Wood Products (B&O Tax)**

**Trade-Ins (Sales and Use Tax)**



# 2016 reviews summary: Legislative Auditor recommends allow 2 preferences to expire, and terminate 7

## Allow to Expire

### **Fuel Used by Mint Growers (Sales and Use Tax)**

*Summary: limited incentive to convert*

### **Nonresident Large, Private Airplanes (Sales and Use Tax)**

*Summary: not being used*

## Terminate

### **6 Semiconductor Manufacturing Industry Preferences Contingent on \$1 Billion+ Investment (Enacted in 2003, Multiple Taxes)**

*Summary: not being used*

### **Syrup Taxes Paid (B&O Tax)**

*Summary: not meeting objective*

# Ten-year history recap

## Recap of Legislative Actions on Prior Reviews (Through 2016 Sessions) 2007 - 2015 Studies

### Implementation of Legislative Auditor Recommendations

Legislative Auditor Recommendation	Implemented	Bill introduced, but not enacted	Made different policy choice	Allowed to expire	No action taken	Total
Allow to Expire			2	7		9
Continue and Modify Expiration Date	1			6		7
Review and Clarify	7	60		4	20	91
Terminate	2	5			2	9
<b>Total</b>	<b>10</b>	<b>65</b>	<b>2</b>	<b>17</b>	<b>22</b>	<b>116</b>
<i>In addition to the Legislative Auditor recommendations above, there were 119 recommendations to continue the preference, requiring no legislative action.</i>						<b>119</b>
<b>Grand Total</b>						<b>235</b>

For 27 of the 242 reviews, the Commission adopted a different recommendation than the Legislative Auditor:

### Implementation of Citizen Commission Recommendations

Commission Recommendation	Implemented	Bill introduced, but not enacted	Made different policy choice	Allowed to expire	No action taken	Total
Allow to Expire			1	2		3
Review and Clarify	2	7		3	2	14
Terminate		5				5
<b>Total</b>	<b>2</b>	<b>12</b>	<b>1</b>	<b>5</b>	<b>2</b>	<b>22</b>
<i>In addition to the Citizen Commission recommendations above, there were four recommendations to continue the preference and one recommendation to allow the preference to expire, requiring no legislative action.</i>						<b>5</b>
<b>Grand Total</b>						<b>27</b>

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<http://leg.wa.gov/jlarc/taxReports/2016/default.htm>

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